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CHINA AND TAIWAN IN 1987*

Jonathan D. Pollack

January 1988

CHINA

Two interrelated processes dominated Chinese politics in 1987: resolving the succession arrangements for the country's aged revolutionary-era leaders, and sustaining efforts at economic and political reform. Political tensions in the aftermath of student demonstrations late in 1986 appeared to momentarily threaten the succession plans advocated by 83-year old Deng Xiaoping, the principal architect of China's extraordinary shifts of the past decade toward market-oriented socialism and away from the dominance of the Chinese Communist Party (CCP) in all spheres of China's economic life. But the CCP's 13th National Congress in late October and early November approved Deng's plans for virtually all senior leaders to resign their posts, with the positions filled by leaders in their 60s and 50s better able to carry out China's modernization agenda. At the same time, China remained strongly committed to its "opening to the outside world," including the further expansion of the country's economic and technological ties with the advanced industrial nations. Relations with

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the Soviet Union experienced further improvement, but Chinese displeasure over several Congressional actions and U.S. unhappiness over Chinese arms sales to Iran proved somewhat disturbing to Sino-American ties. Heightened political and economic tensions with Tokyo also created uncertainties in the Sino-Japanese relationship.

Domestic Affairs. Contention over leadership succession dominated the Chinese political agenda for much of the year. Following student demands of the early winter for increased freedom of expression, Hu Yaobang, Deng's hand-picked choice as CCP General Secretary, resigned his post in mid-January, with the position filled on an acting basis by Premier Zhao Ziyang, whom Deng had previously chosen to implement and coordinate the economic reform process. Some Party elders troubled by Hu's departures from ideological orthodoxy used his resignation as an opportunity to regain political ground. Harsh attacks on "bourgeois liberalization" were followed in quick order by renewed limits on intellectual expression and a reemphasis on the "four cardinal principles" that enshrined Party dominance over the nation's political life. Although Deng remained a leading advocate of economic change, he also strongly endorsed the renewed curbs on intellectual expression, which he saw posing a threat to the principle of Party supremacy.

By mid-winter, however, key reformists (including Zhao) sought to limit the political damage wrought by heightened leadership tensions. Zhao insisted that the campaign against "bourgeois liberalization" be strictly confined to internal Party matters, lest it create doubts at home and abroad about the CCP's commitment to further economic reform. In May, Deng offered strong support for Zhao, asserting that "ossified

leftist thinking" represented a greater threat to China's prosperity and stability than any challenge posed by "bourgeois liberalization."

Having conveyed his support for the reformist course, Deng turned his attention to the leadership succession issue. Deng had long been a critic of lifetime tenure in office, and in recent years had engineered the resignation of large numbers of senior officials from their entrenched bureaucratic power bases. In Deng's estimation, it was crucial for China's longer-term economic and political prospects to bequeath political power to younger, more highly educated officials. He also viewed this step as vital to rejuvenating the Party at all levels, whose membership now exceeded 46 million. Having repeatedly emphasized his own desire to retire from various leadership posts, Deng sought to convince other Party elders--including conservative critics of rapid economic and political change--to follow suit.

Despite resistance in some quarters to his plans, Deng ultimately engineered the resignations of virtually all senior CCP officials from their leadership positions. In addition to Deng, those stepping down from the Political Bureau included Chief of State Li Xiannian, senior economic planner Chen Yun, legal and security affairs specialist Peng Zhen, military leaders Yang Dezhi and Yu Qiuli, and veteran ideologist Hu Qiaomu. Deng, however, opted to retain his chairmanship of the Party Military Commission, with Zhao Ziyang named First Vice Chairman.

The new Political Bureau appointed at the Party Congress was smaller (17 members rather than 20) and younger (an average age of 65 rather than 70). The average age in the Political Bureau Standing Committee dropped from 77 to 64. Zhao Ziyang, a highly vigorous 68, was named the new CCP General Secretary and head of the Standing Committee.

Zhao was joined on the Standing Committee by four newcomers to this ranking leadership body: Li Peng, a Soviet-trained engineer responsible in recent years for various economic management tasks; Party administrator Qiao Shi; Hu Qili, regarded as a leading reform advocate; and veteran economic planner Yao Yilin. Hu Yaobang, although yielding his seat on the Standing Committee, retained his membership in the Political Bureau.

Following the Party Congress, Zhao Ziyang resigned the Premiership. He was succeeded on an acting basis by Li Peng, whose appointment to the post will be formally ratified in the spring of 1988. Although most political observers deemed Li more cautious in his approach to economic reform than Zhao, these differences in viewpoint were not expected to lead to major movement away from the reform objectives.

Zhao sought to enshrine many of these objectives in his political report delivered at the Party Congress. The speech emphasized the broad contours of CCP policy for the coming half decade, rather than extensive details. According to Zhao, China still remained "in the primary stage of socialism" that would continue at least through the middle of the next century. As such, China would not be able to leapfrog various intermediate stages on the road to fully developed socialism. The country instead would have to expand its productive capabilities by all possible means, while also undertaking "comprehensive reform" of its political and administrative structure. This would include enhancing the opportunities for improved management, increasing initiative and autonomy among individual enterprises, and commercialization of many areas of the economy, including housing.

Among various tasks, Zhao placed particular stress on economic restructuring, whereby the direct economic control exercised by the state would steadily diminish. Establishing a "socialist market system" and reliance on indirect control of enterprises was expected to increase the capabilities and incentives of enterprises to produce more, and depend less on central planners for resources and policy guidance.

Zhao also gave great emphasis to reform of the political structure. The goal of political reform had proven a highly contentious issue in recent years. Zhao stressed the need to separate the functions of party and government, which meant curtailing the Party's monopoly of decisionmaking authority, especially for economic matters and for local-level policy. Other measures would be introduced to reduce the ability of political authorities to exercise their powers arbitrarily, and to professionalize numerous bureaucratic appointments through a competitive examination system. Many of these objectives were clearly long-term goals rather than near-term proposals. By setting forth these tasks in a comprehensive manner, the new Party leadership hoped to generate political support at all levels for the step-by-step transformation of China's political and administrative processes.

The Economy. Chinese planners continued to grapple with the complexities of the transition to a mixed economy involving both market and plan. Although economic reformers sought to limit the powers exercised at a macro level, they had yet to devise an effective means to maintain indirect control over economic growth, in particular unchecked expenditure by individual enterprises and by local governments in the rural areas. The economy grew at a very rapid rate, with industrial

output increasing more than 14 percent over the previous year. But planners expressed mounting concern about the risks posed by uncontrolled growth, given that demand vastly outstripped available supplies of energy, raw materials, and high quality producer and consumer goods.

Some of the biggest problems included a major expansion of money supply (a full 50 percent increase in the first half of the year), rapid price increases in the cities for various foodstuffs and consumer items, excessive consumption, and uncontrolled investment. All these developments threatened the pattern of balanced growth desired by planners. According to non-governmental estimates, inflation in the cities approached 20 percent, resulting in soaring living costs for workers. At the same time, it was proving increasingly difficult to regulate the activities of individual enterprises, which were now far less subject to central control over allocation of funds and the distribution of profits. More often than not, enterprises sought to return profits to workers through across-the-board wage increases, rather than reinvesting such surpluses in new production technology.

To curb major excesses, planners sought to reintroduce some of the controls on prices that had been relaxed in recent years, while also searching for more effective mechanisms to curb enterprise over-investment. The central bank reimposed limits on credit, and attempted to reclaim some of the surplus funds now in circulation. Efforts were also under way to shift investment to vital but long neglected infrastructural tasks in transportation, communication, and resource development, as mandated by the Seventh Five Year Plan (1986-1990). But no easy answers to acquiring sufficient funds for large-scale projects were in sight.

Related problems hampered the agricultural sector, the leading success story of the economic reforms of the past decade. The development of small-scale industry and the emergence of a service sector in the Chinese countryside had resulted in major shifts in the labor force, with tens of millions of peasants moving away from agricultural production. But changing patterns in land use and manpower availability led to higher feed grain prices and reduced production of pork, necessitating a decision in December to ration pork supplies in most major cities.

China did achieve greater success in correcting the nation's growing trade imbalance, with the country reporting its first trade surplus since 1983. In recent years, China's desire for foreign products and advanced technology had vastly outstripped the country's ability to pay for them, resulting in major reductions in Beijing's foreign exchange reserves. At the same time, decentralization of the foreign trade system meant that officials in Beijing exercised far less oversight and control over this process, with China importing large quantities of consumer goods, machinery, and automobiles, especially from Japan. The decline of export earnings from crude oil and petroleum products posed additional problems.

China addressed these problems by three methods: greatly restricting imports of finished products from abroad, launching a major new export push, and increasing the country's foreign borrowing. Purchases of consumer goods (in particular, automobiles, motorcycles, and household appliances) again returned to modest levels. Japan (which alone accounted for more than half of China's trade deficit in 1986)

bore the brunt of these cuts. The central authorities also limited purchases of building materials from abroad as part of a larger effort to slow the pace of capital construction.

In the export sector, China attempted to compensate for declining oil revenues by accelerating its sales of textiles, coal, and foodstuffs. Fueled in particular by a major push in textiles, the value of Chinese exports increased nearly 30 percent during 1987. Although Japan remained China's largest trading partner, Hong Kong was now China's biggest export market. Trade with the United States declined slightly, but still surpassed \$8 billion for the year. Trade with Western Europe and West Germany in particular registered impressive increases, with China importing substantial quantities of industrial equipment and advanced technology.

China also was looking abroad for loans to help finance major industrial projects. During the first six months of the year, China became the largest borrower among Asian states. In addition, China began to more actively tap new sources of funds, including bond markets in the United States. Although China's total foreign debt was expected to surpass \$32 billion by the end of 1987, most economists believed that (unlike many Third World states) the country's debt service was manageable, especially given recent successes in export promotion.

However, the outlook for direct foreign investment remained somewhat more clouded. Although new regulations for foreign investment introduced in late 1986 seemed more attractive, foreign businessmen showed continued caution in these decisions, with pledged investments dropping significantly early in the year. These declines also reflected foreign concern about the political climate in China after Hu Yaobang's

resignation. To allay these fears, Chinese leaders repeatedly stressed that recent leadership changes would not alter China's long-term commitment to increase its involvement in the world economy and attract foreign capital to assist the nation's modernization drive.

Foreign Affairs. Chinese foreign policy priorities continued to emphasize the reduction of military tensions and the enhancing of China's international political and economic contacts to facilitate internal development. Despite making headway in both areas, there were also uncertainties and complications, especially in relations with Japan but extending in some aspects to Sino-American relations, as well.

Chinese-Japanese differences were both economic and political. Although China's largest trading partner, Japan remained wary of investing substantial sums in the Chinese modernization program. As a result, Beijing accused Tokyo of viewing China solely as a market for Japanese goods, and of withholding advanced technology from Chinese industry. China combined its efforts to reduce imports of Japanese goods with calls for Japan to extend further low-interest loans.

China also voiced increased concern about the growth of Japan's military power. Japan's decision to surpass one percent of its gross national product in defense expenditure was greeted very warily in Beijing, with China warning against the possibility that Japan might ultimately assume a larger security role. Chinese officials also voiced repeated objections to a Japanese court decision awarding ownership of a student dormitory in Kyoto to the governmental authorities in Taiwan, with Beijing decrying this step as tantamount to a "two Chinas" policy. Despite such tensions, China reiterated its desire to sustain amicable long-term relations with Japan, and invited Noburu Takeshita, the newly elected Prime Minister, to visit China during 1988.

Closer ties with the United States remained a vital policy objective for China, but irritants to the relationship also developed. In March, Secretary of State Shultz traveled to Beijing, reassuring Chinese leaders of the U.S. intention to broaden relations in all areas. In May, General Yang Shangkun, China's most important military leader, made a first-ever visit to the United States, reiterating Beijing's interest in sustaining informal security cooperation between the two countries. The importance of the United States to China's modernization agenda was underscored by China's increased purchases of high technology from American companies, including some in the defense sector. At the same time, more than 19,000 Chinese students were enrolled in American universities for advanced degrees, with particular emphasis on training in science and engineering.

Many of the problems in Sino-American ties reflected the growing institutionalization of relations between the two countries. The Chinese government objected strenuously to various American actions that Beijing deemed unwarranted intrusions into its domestic affairs. Following a late summer visit by the Dalai Lama, the exiled Tibetan religious leader, to Capitol Hill, violent demonstrations occurred in the Tibetan capital of Lhasa led by Buddhist monks protesting Chinese rule. The Ministry of Foreign Affairs voiced strenuous objections to expressions of Congressional support for Tibetan autonomy. The Reagan administration vigorously objected to Chinese sales of Silkworm missiles to Iran because they threatened shipping in the Persian Gulf; the missile sales also placed on hold various requests for additional modifications in U.S. policy regarding high-technology exports to China.

But agreement was reached by the two sides in December limiting future increases in Chinese textile exports to the United States, which posed a growing challenge to the American apparel industry.

China also sought to further enhance its relations with the Soviet Union. Despite Beijing's political and security grievances against Moscow, Sino-Soviet ties continued their marked improvement of recent years, with the USSR now among China's leading trading partners. Sino-Soviet trade in 1987 approached \$2.5 billion, mostly conducted on a barter basis and not requiring expenditures of hard currency. Modest steps began in Soviet pledges to help refurbish various industrial facilities constructed with Soviet assistance in the 1950s, but these programs were still dwarfed by the Western contribution to the modernization effort.

China also expressed a growing interest in Mikhail Gorbachev's efforts at political and economic reform, with many Chinese officials noting similar challenges confronting the world's two largest socialist societies. But Beijing insisted that the acid test for future ties remained the "three obstacles" that blocked a more comprehensive improvement in relations: the Soviet military presence in Mongolia and along the Sino-Soviet border, the Soviet occupation of Afghanistan, and Moscow's continued support for the Vietnamese occupation of Cambodia.

Chinese officials saw some positive trends in several of these areas but concluded that Moscow was not yet prepared to reach a broader reconciliation with Beijing. During bilateral talks in August, the two sides made some progress toward resolving claims along the eastern sector of the Sino-Soviet border, and announced the formation of expert groups to further adjudicate various disputes. China described Moscow's

growing self-confidence and stability. In July, martial law was lifted after 38 years, replaced by a national security law with much more explicit guarantees of individual rights, increased freedom of movement abroad, relaxation of most foreign exchange controls, and greater opportunities for political participation. Passage of the new law reflected the increased flexibility and pursuit of political reform by the ruling Kuomintang (Nationalist Party), and portended a further opening of the political process, including the sanctioning of a formal political opposition.

The Kuomintang's commitment to greater openness and political participation reflected increased concerns about the ruling party's power base. With most top level political positions still occupied by aging mainlanders who fled to the island in 1949, new measures were required to rejuvenate support for the party, especially among the increasingly affluent Taiwanese who comprised 85 percent of the population. The Kuomintang made clear its resolve to combat calls for Taiwanese independence or self-determination, some of them voiced by the one year old Democratic Progressive Party. The opposition forces also pressured the Kuomintang to allow elections for all seats in the legislative body, where at present only a limited number are open to electoral competition.

The role of Chiang Ching-kuo, Taiwan's aging but still powerful president, remained crucial to sustaining the political reform process. Chiang's authority enabled him to overcome resistance to many of the reforms among more conservative elements in the party leadership. But numerous observers expressed concern about the succession to Chiang Ching-kuo, now 77 years old and in uncertain health. Most speculation

centered on Li Huan, Chiang's long-time confidant who was named Kuomintang Secretary General. Others noted the prominence given to Vice President Li Teng-hui, a Taiwanese native.

Equally dramatic developments occurred in relations with the Chinese mainland. Although the Kuomintang insisted that it would continue to reject any official contract with leaders on the mainland, these declarations obscured a growing flexibility in unofficial dealings. In late July, restrictions on travel to Hong Kong and the Portuguese enclave of Macao were lifted. In mid-September, two young reporters visited the mainland in anticipation of a pending decision to ease travel restrictions. A month later, a new policy was promulgated permitting Taiwan citizens other than military and government personnel to visit their relatives on the mainland. Approval of this measure produced a flood of requests for such visits, as Taiwan residents had been denied this opportunity for nearly four decades. Indirect trade between China and Taiwan also flourished, and was expected to reach \$2 billion by year's end.

The key to Taiwan's social and political stability remained its continuing economic success. Led by a further surge in exports, economic growth for the year was projected at 10.6 percent, with per capita income surpassing \$5,000. Trade relations with the United States were crucial to this export strategy, with nearly 45 percent of the island's exports shipped to American markets, propelling Taiwan to the top five among U.S. trading partners. The U.S. trade deficit with Taiwan surpassed \$19 billion for the year, second only to Japan among America's overseas trading partners and far larger than Japan's surplus in per capita terms.

Although many of Taiwan's export gains were registered by local subsidiaries of U.S. companies, the widening trade gap fueled protectionist sentiment in the United States. Under pressure from the Reagan administration, Taiwan's currency appreciated sharply against the U.S. dollar. Taiwan sought to resist pressures for further shifts by committing itself to larger purchases of U.S. products, lowering numerous tariff barriers to imports, and by stimulating domestic demand. Despite such measures, the central bank's hard currency reserves continued to grow, and by year's end approached \$70 billion, holdings exceeded only by Japan and West Germany. Economic planners hoped that the exponential growth in the money supply could be turned to domestic investment, lest inflationary pressures create major economic uncertainties in the future.